

Office of Chief Counsel
Internal Revenue Service

memorandum

CC:WR:SCA:SDGL-801728-00
KNSommers

date: MAR 21 2000

to: Patrick McGuire, Technical Advisor
Taxpayer Advocate Service Laguna Niguel, CA

from: Karen Sommers, Attorney
San Diego Associate District Counsel Office

subject: Carryback of Net Operating Loss

Taxpayer: [REDACTED]
[REDACTED] Form 1040

DISCLOSURE LIMITATIONS

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This advice is not binding on the Internal Revenue Service and is not a final case determination. Such advice is advisory and does not resolve Service position on an issue or provide the basis for closing a case. The determination of the Service in the case is to be made through the exercise of the independent judgment of the office with jurisdiction over the case.

ISSUE

Must the net operating loss reflected on the [REDACTED] return, filed more than three years after its due date, be carried back to [REDACTED], [REDACTED], and [REDACTED], and, if so, what is the effect of the

carryback on the taxpayer's outstanding liability for the carryback years?

FACTS

The following shows the return filing and payment dates for [REDACTED]'s [REDACTED] through [REDACTED] income tax liabilities.

<u>Year</u>	<u>Dated filed</u>	<u>Tax Assessed</u>	<u>Payment amount/date</u>
[REDACTED]	[REDACTED]	\$ [REDACTED]	paid in full in [REDACTED]
[REDACTED]	[REDACTED]	\$ [REDACTED] (current balance: \$ [REDACTED])	\$ [REDACTED] [REDACTED]
[REDACTED]	[REDACTED]	\$ [REDACTED] (current balance: \$ [REDACTED])	\$ [REDACTED] [REDACTED] (withheld tax)
[REDACTED]	[REDACTED]	\$ [REDACTED] (current balance: \$ [REDACTED])	\$ [REDACTED] [REDACTED] (withheld tax)

The Service had made earlier assessments of tax for [REDACTED] through [REDACTED] based on substitutes for returns. These assessments were reduced via partial abatements in [REDACTED], after the taxpayer filed returns. There were no waivers extending any limitations period with respect to any of the years shown, and no extensions of time to file returns.

The [REDACTED] return contained a statement electing to forgo any net operating loss carryback. However, on [REDACTED], the taxpayer sent a letter to the Service requesting that the [REDACTED] through [REDACTED] returns be abated as "wrong", although she did not specifically mention NOL carrybacks as a basis for abatement. The Taxpayer Advocate's office requested Counsel's opinion on whether any statute of limitations prevented the carryback of the NOL to [REDACTED] and subsequent years, for the purpose of overpayment refunds or for reducing the taxpayer's outstanding liabilities.

To the best of our knowledge, the Examination Division has never considered the validity of the claimed [REDACTED] loss. This office was not asked to provide an opinion on the issue of the validity of the loss. The following discussion is based upon the assumption that Examination has made or will make a factual determination that the taxpayer incurred the loss and that the

loss meets the definition of a net operating loss under § 172(d).

DISCUSSION

The first issue to be resolved is whether the taxpayer's statement on the [REDACTED] return was a proper election to forgo the three-year carryback provisions of I.R.C. § 172(b) (as in effect for taxable years beginning before August 5, 1997). Section 172(b)(3) permits a taxpayer to elect to forgo any carryback and carry a net operating loss forward, but only if such election is made before the due date of the loss year return, including extensions. In this case, the taxpayer's election was made on a return filed over five years late, so she did not make a timely election and is required to carry back the [REDACTED] net operating loss to [REDACTED], [REDACTED], and [REDACTED] before carrying it forward.

The next issue to be determined is the effect of the carryback from the [REDACTED] loss year on the taxpayer's outstanding tax liabilities, and whether refunds are allowable with respect to [REDACTED] (the fully paid year), or with respect to the partial payments made toward the [REDACTED] liability.

I.R.C. § 6511(a) provides that claims for credit or refund of any tax, in respect of which tax the taxpayer is required to file a return, must be filed before the later of 2 years from the date the tax was paid, or 3 years from the date the return was filed. I.R.C. § 6511(d)(2) provides an additional special period of limitation with respect to a claim for a refund or credit relating to an overpayment attributable to a net operating loss carryback. For this case, the relevant portion of § 6511(d)(2) provides, in lieu of the 3 year period of limitation prescribed in § 6511(a), the period shall be the period ending 3 years after the due date of the return (plus extensions) for the taxable year of the net operating loss.

Thus, for this case, the additional special limitation period permitted by § 6511(d)(2) expired on [REDACTED], with respect to any refund based on NOL carrybacks attributable to the [REDACTED] tax year. The [REDACTED] claim is over 5 years late under § 6511(d)(2). And, even if the [REDACTED] return filed in [REDACTED] were treated as a claim, it is likewise untimely under § 6511(d)(2). Accordingly, only § 6511(a) is applicable to any refund claimed in this case.

It is clear that the taxpayer is not entitled to any refund for [REDACTED] under § 6511(a), since the return was filed and the entire tax was paid more than seven years before the earliest possible claim date in this case. The withholding credits applied to the [REDACTED] and [REDACTED] tax years, in [REDACTED] and [REDACTED],

respectively, cannot be refunded because they are likewise barred by § 6511(a). However, § 6511(a) would permit the payments made in [REDACTED] toward the [REDACTED] liability to be refunded if there is an overpayment determined for that year based upon the [REDACTED] claim, since the payments were made within two years before the claim date.

Even though § 6511(d)(2) bars refunds based solely upon the late [REDACTED] NOL return, the [REDACTED] NOL must nevertheless be carried back to [REDACTED] and then forward, and taxable income recomputed. Section 172 and the regulations thereunder contain no time limits which would permit the avoidance of this mandatory carryback computation, regardless of whether the taxpayer ever filed a timely refund claim under § 6511. I.R.C. § 172((b)(2); Treas. Reg. § 1.172-4(b)(1); Tekwari v. Commissioner, T.C. Memo. 1986-194. According to the calculations prepared by the Taxpayer Advocate's office, if the NOL reflected on the [REDACTED] return is correct, when it is carried back to [REDACTED] and then forward, it will eliminate the previously reported taxable income for [REDACTED] and [REDACTED], and partially reduce [REDACTED] taxable income, after which point it will have been fully absorbed.

As previously explained, any refund with respect to the [REDACTED] tax year is barred by § 6511(a), and § 6511(d)(2) does not help the taxpayer in this case. The payments made in [REDACTED] toward the [REDACTED] liability could be refundable under § 6511(a) based upon the [REDACTED] claim, since the payments were made within two years before the claim. An illustration of this process is contained in a recent case, United States v. Neary, ___ F.3d ___, 85 AFTR2d 2000-515 (5th Cir., Mar. 8, 2000). In Neary, the Government stipulated that a taxpayer was entitled to use an NOL carryback, long after the § 6511(d)(2) limitation period based on the loss year had expired, in order to reduce the tax liability for the carryback year and obtain a refund of all payments made to the carryback year within two years of the claim date as permitted by § 6511(a).

In the instant case, however, a substantial self-employment tax liability remains due for [REDACTED], which is not affected by NOL carrybacks. (The assessed tax liability for [REDACTED] is about [REDACTED] % self-employment tax and [REDACTED] % income tax.) Penalties and interest on the self employment tax portion of the liability will remain due, as well as penalties and interest on the original underpayment of tax up until the filing date of the [REDACTED] taxable year. I.R.C. §§ 6601(d), 6651(b). It appears that the reduced [REDACTED] taxable income after the carryback from [REDACTED] to [REDACTED] and


█████ would not result in an overpayment.¹ The taxpayer would simply have a reduced outstanding liability.

There is no statutory impediment to the Service's abating the income tax liability of the taxpayer due to the reduction of taxable income as a result of the carryback discussed herein. I.R.C. § 6404(a)(1) authorizes the abatement of any tax which is excessive in amount.

CONCLUSION

If the Service determines that the net operating loss reflected on the █████ return has been substantiated, and qualifies under § 172, such loss should be carried back to █████ and then forward until absorbed, and appropriate tax abatements processed. No refund is allowable to the extent there is an overpayment in █████ generated by the carryback. In the unlikely event that any overpayment is generated in █████, payments made within 2 years before the refund claim would be refundable under § 6511(a).

If you have any questions, please contact me at 557-6014.



KAREN NICHOLSON SOMMERS
Attorney

¹Because there appears to be no likelihood of this matter resulting in an overpayment in █████ (and because no part of █████'s overpayment may be refunded under any view of the facts), it is unnecessary to delve into the issue of whether the █████ letter or the █████ return filed in █████ were "claims" sufficiently explicit to apprise the Service of the taxpayer's position on the NOL carryback. The taxpayer's position is confused, but if the Service determines that there was an NOL in █████, the carryback calculations are required by § 172 irrespective of any action on the taxpayer's part.